



# ARIZONA STATE RETIREMENT SYSTEM

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Paul Matson  
Director

## SUMMARY OF THE REGULAR MEETING OF THE ARIZONA STATE RETIREMENT SYSTEM EXTERNAL AFFAIRS COMMITTEE

HELD ON  
December 1, 2006  
9 a.m., MST

The External Affairs Committee (EAC) of the Arizona State Retirement System (ASRS) met in regular session in the 14<sup>th</sup> Floor Conference Room of the ASRS Office, 3300 North Central Avenue, Phoenix, AZ, 85012. Mr. Jaime Gutierrez, Chairperson, called the meeting to order at 9 a.m.

This meeting was teleconferenced to the ASRS Tucson office at 7660 East Broadway Boulevard, Suite 108, Tucson, Arizona, 85710.

### 1. Call to Order; Roll Call; Opening Remarks

Present: Mr. Steven Zeman, Vice-Chair  
Dr. Keith Meredith, Member

Teleconferenced: Mr. Jaime Gutierrez, Chairperson

Absent: Mr. Christopher Harris, Member

A quorum of the Committee was present for the purpose of conducting business.

### 2. Approval of Minutes of the August 4, 2006 EAC Meeting

*Motion:* Mr. Zeman moved that the External Affairs Committee approve the minutes of the August 4, 2006 EAC meeting.

Dr. Meredith seconded the motion.

By a vote of 3 in favor, 0 opposed, and 0 abstentions, and 1 excused the motion was approved.

### 3. Presentation, Discussion and Appropriate Action Regarding 2007 Legislative Issues.

Mr. Gutierrez deferred to Patrick Klein, Assistant Director, and Lesli Sorensen, Government Relations Office, to present the 2007 Legislative issues.

Mr. Klein began by updating the members on various associations to which he and Ms. Sorensen, at Director Paul Matson's request, did an outreach. This outreach included the list of the 2007 ASRS legislative initiatives. The goal was to get their feedback on the ASRS legislative initiatives. He then restated each of the legislative items. Mr. Klein informed Mr. Gutierrez that there were public present, and some who wished to speak. It was decided that speakers would be called upon as the issue was discussed rather than waiting until the Call to the Public at the end of the meeting.

Mr. Klein presented to the Committee the **Defined Benefit Plan Design Omnibus Initiatives**. Mr. Klein confirmed that Representative McClure will be supporting these initiatives.

1. Average Monthly Salary

Modifies the pension calculation to include a five-year average of compensation rather than a three-year average. This proposal applies to new members only.

Mr. Gutierrez asked how many members currently benefited from the 60 month calculation versus the 36 month calculation. Mr. Klein could not respond to the question. Mr. Klein explained that it depends upon the dollar amount of the lump sum payments that are included in the 60 month calculation that would determine whether the 60 month or 36 month calculation would benefit the individual.

Dr. Meredith asked Mr. Klein to speak to the anti-spiking aspect of this issue.

Mr. Klein explained that a practice exists within ASRS Employer groups whereby a person's salary, towards the end of their career, can be augmented through various means. Using a 60 month calculation as apposed to a 36 month calculation mitigates salary spiking. Quite a number of cases where salary spiking is utilized have been uncovered. The numbers revealed that in 2003, in excess of 1,100 individuals spiked their salary. However, if we move forward with the 60 month calculation, it will, by virtue of the mathematics, mitigate the salary spiking issue.

2. Rule of 85

Extends the normal retirement "Rule of 80" to a "Rule of 85" (years of service plus age). This proposal applies to new members only.

It was explained that because people are living longer, the rule of 80 does not seem to be a practical application. By moving the rule to 85, a member would have to work until age 52 ½ and achieve 32 ½ years of service in order to reach a normal retirement date. This re-application of the rule mirrors what is happening in society. People are living longer. Social Security Administration recognized this by pushing back to age 66 and 67 when retirees may receive unreduced Social Security retirement benefits.

3. Enhanced Refunds

Eliminates the "enhanced" refund provision in which an employee with five or more years of service receives a portion of the employer contribution upon termination of membership and withdrawal of their account balance. This proposal applies to new members only.

This initiative requests of the legislature to return to pre-1999 where the ASRS did not provide employer contributions when a member terminates ASRS membership. Part of the ASRS goal is to retain and attract individuals for the long haul for the benefit of public service. We do not retain individuals when we give them a savings account they can take with them when they leave. While a person is always entitled to the value of the money they have contributed, employer contributions should remain in the trust for the benefit of providing life-long retirement benefits.

Mr. Gutierrez asked if this and the Rule of 85 had been before legislature last year. Mr. Klein responded that Average Monthly Salary and the Rule of 85 are new initiatives.

Dr. Bob Letson addressed the issue of refunds. Dr. Letson feels an individual who works for a period of time should receive the funds that are put in by the employer. Employer is reporting benefits that they put into the contribution, so that is part of the salary. Now, according to Dr. Letson, the ASRS is describing employer contributions as not part of the salary.

Mr. Klein responded that the items that would constitute a benefit have received considerable attention. While Dr. Letson makes a good point, Mr. Klein stressed that the ASRS had already addressed those issues from a legal perspective, and will continue to do so in future.

4. Overpayment Recoupment

Allows the ASRS to recapture any overpayment from any benefit paid by the ASRS (including an LTD benefit), from any source (such as a member, beneficiary, alternate payee, or contingent annuitant).

This initiative is mainly with respect to those who become disabled and ultimately receive a Social Security Disability benefit. See right hand column of page three previous initiatives. This initiative attempts to legitimize what the ASRS is currently doing to recapture overpayments.

Membership Clarification

Clarifies that the member is entitled to the benefit structure in place on the date the member is hired (for active and inactive members), the date the member transfers into the ASRS (for transferred members), and the most recent hire date (for members who reinstated forfeited service).

Ms. Sorensen addressed the Committee and explained that this initiative codifies the current ASRS policies, procedures and practices, and provides clearer understanding of which members fit into the new benefit structures.

Dr. Meredith commented that the first three items of the Omnibus requires some philosophical change.

Mr. Gutierrez asked of Mr. Klein what the overall response was from the outreach on these five issues.

Mr. Klein responded that the associations understood why the ASRS was proceeding down this path. They also understand it does not affect any current employees, and were cognizant of the fact that some of these issues were presented last legislative session. The general feeling was that these were necessary initiatives in order to maintain the integrity of the Defined Benefit Plan. There was general support.

Mr. Klein then presented to the Committee the **Long-Term Disability Omnibus Initiative**.

1. Membership Definition

Limits the definition of member to a member of the ASRS who is actively contributing, i.e., not inactive or retired.

Mr. Klein explained that this initiative conforms to current ASRS policies, procedures and practices.

2. Social Security Offsets

Changes the Social Security offsets (from 64% of SS Disability and 83% of SS Retirement to 100%). This proposal applies to new disabilities only.

Mr. Klein explained that it is industry standard (both public and private) to offset 100% of all income while on disability. In some cases, a person makes more money while on LTD than working. This initiative will help mitigate the upward pressure on the LTD Program contribution rate, and help decrease the unfunded status.

3. Pre-existing Conditions (LTD Program)

Changes pre-existing condition look back provisions from 3 months to 6 months. (Pre-existing condition limitations only apply to people who have worked less than one year). This proposal applies to new members only.

Mr. Klein explained that the industry standard (both public and private) is to look back 6 months for pre-existing conditions. This initiative helps mitigate the potential risk for fraud, in which someone stops receiving medical care only for the look back period and then resumes treatment. This initiative will also help mitigate the upward pressure on the LTD Program contribution rate, and help decrease the unfunded status.

4. Overpayment Recoupment

Allows the ASRS to recapture any overpayment from any benefit paid by the ASRS (including an LTD benefit) from any source (such as a member, beneficiary, alternate payee, or contingent annuitant.)

Mr. Klein explained that this initiative codifies the current ASRS practice of reducing a pension benefit when a member has been overpaid by the LTD Program prior to retirement. This initiative will also allow the ASRS to recoup money overpaid to the member from a survivor's benefit, and will help mitigate the upward pressure on the contribution rate.

Mr. Klein introduced to the Committee the **Investment Management Omnibus Bill**. Ms. Sorensen addressed the topic to the Committee as follows:

1. Investment Management Minimum Qualification Elimination

Eliminates the minimum qualifications for fund managers from statute (three years experience with \$250 million under management and \$250 million currently under advisement).

Ms. Sorensen explained that this initiative corrects the problems IMD faces when experienced firms merge, because the new firm may not have the required experience as defined in statute. Managers who worked as part of a group cannot take their investment "experience" with them under certification rules. Market is moving toward small, boutique and targeted fund offerings and the ASRS would like to take advantage of niche markets.

Dr. Meredith expressed some concerns regarding policies and procedures that protect against elimination of qualifications. He asked if the initiative could be re-worded.

Ms. Sorensen responded, agreeing that the draft language in the initiative could be restated to some extent. However, the Board has a fiduciary responsibility to hire experienced, qualified managers.

Mr. Klein assured the Committee that he and Ms. Sorensen will be working closely with legislative staff, and, hopefully, will assist them in drafting the fact sheets and analysis that will go to legislative committees. They will have the opportunity to posture in better light some of the language.

2. Confidential Information

Establishes that financial or commercial information connected with ASRS's investments are confidential, proprietary and not public record, if the information would not customarily be related to the public by the person or entity from whom the information was obtained.



Mr. Klein explained that during investment negotiations, generally real estate and other investment transactions, the ASRS may receive information about the business or development plans of the potential seller. That information would be released under a public records request, and that release could potentially affect the negotiating position of both parties. Once the transaction is completed, the information will be available. PSPRS passed similar legislation last session.

General discussion took place between Mr. Gutierrez, Mr. Zeman and Mr. Klein. All agreed this is an important issue that needs to be addressed.

3. Increased Foreign Investment Cap

Increases the foreign investment cap from 20% to 35%

Mr. Klein explained that the foreign market may provide a high rate of return for the trust and the current cap limits the ASRS's investments in those areas.

Mr. Zeman expressed concern about the gap between 20% and 35% being too great and suggested that over time it be increased incrementally eventually up to the 35%.

Mr. Klein responded by assuring Mr. Zeman that there was not the intention of jumping immediately to the 35%, but will increase as the market allows. The intent of having the full 35% approved would be so that if a situation presents itself, that IMD have the flexibility to take advantage of it.

Mr. Gutierrez asked to move to the next item. Mr. Klein then presented to the Committee the **Investment Management; Procurement Exemption.**

Exempts the ASRS from the state procurement process for the appointment of Investment Managers or investment related services.

Mr. Klein explained that Investment Management has missed out on positive investment returns because of the time requirements of the RFP process. Required insurance is not always appropriate or obtainable for the investments being considered and often there is only one provider for a particular service. ASRS has internal procedures that mimic the RFP process, but is customizable to our needs.

A general discussion took place between Dr. Meredith and Ms. Sorensen. It was agreed that IMD needed some support such as this and other initiatives, in an effort to operate more efficiently.

Mr. Klein then presented to the Committee the **Federal Conforming Changes initiative.**

1. Social Security Coverage

Removes obsolete language that requires ASRS employees be included in an "agreement" with SSA and replaces with federal conforming changes requiring ASRS employees be "covered". The term "agreement" is no longer a federal requirement.

Mr. Klein then presented to the Committee the **Military Service Credit Bill.**

1. Military call-up

Modifies existing statute to consistently replace "presidential" call-up with the term "military call-up."

2. Credit for Military Service

Extends credited service rights to military call-ups who are disabled or die and the disability or death occurred during military service.

Mr. Klein explained that this initiative fills holes in the current statute that allows service credit for deceased member who return to work for the same employer, but not for a disabled member who cannot return to work.

Mr. Klein then presented to the Committee the **Unclaimed Property Exemption Bill**.

Exempts the ASRS from the Department of Revenue's unclaimed property statutes. Establishes ASRS's unclaimed property procedure, which authorizes the ASRS to cease interest accrual, deposit into the Fund, and take an actuarial gain on "unclaimed" members' accounts (which under DOR is 3 years after abandonment), if the member has reached age 73.5. The ASRS will send annual letters to the member from age 65 to age 73.5 before considering the account unclaimed. If the member returns after age 73.5, the ASRS will give the member the benefit due.

Mr. Klein explained that this initiative will keep money in the Trust Fund, which increases the ASRS's overall investment purchasing position. An inactive member always has a right to come back and receive a pension benefit, and sending the money to DOR could potentially negatively impact that right.

A general discussion took place between Mr. Gutierrez, Dr. Meredith, Mr. Zeman, Mr. Klein, Ms. Sorensen, Mr. McClory and Ms. Linssen about how much money in unclaimed funds there is that would benefit the ASRS and where that money currently goes. There is not an exact dollar amount on this question posed by Mr. Gutierrez, and Mr. Klein confirmed that they would be able to provide those numbers to the Board at the next meeting.

Mr. Klein introduced to the Committee the **Supplemental 401(a); Matching Contribution Bill**. Ms. Sorensen addressed the topic to the Committee as follows:

This initiative allows the Employer to match an employee's contribution to *any* Employer savings plan (i.e. 403(b), 457, 401(a)) and contribute the employer's matching money into the Supplemental 401(a) Plan. It removes the requirement that the Employer must deposit matching contributions to the plan in which the employee participates and the Internal Revenue Code limits must be met prior to matching into the supplemental 401(a) plan.

Ms. Sorensen explained that our employers who are currently contributing to their employees' 457 Plans are running into IRS contribution limitations and are seeking a different place to contribute their money so that the employee gets the maximum deferrals under 457, while also keeping their employer money.

Mr. Gutierrez confirmed that all of the agenda items for #3 had been covered and asked if there were any further questions or comments. None present had any further comments.

*Motion:* Mr. Zeman then moved that the Committee recommend to the Board of Trustees the 2007 legislative initiatives presented by staff, with the intention that the Board supports all initiatives, with the exception of the Rule of 85 and Average Monthly Salary provisions, on which the Board should have a "neutral" position, but shall provide information to the Legislature on the impact of the initiatives on the Fund. Staff may make all language changes and negotiate as necessary to obtain the most effective and efficient legislative provisions within the construct of today's proposals.

Dr. Meredith seconded the motion, and asked of staff that as language does get replaced in these initiatives that it return to the Committee for review. Mr. Klein agreed to provide any subsequent changes.

By a vote of 3 in favor, 0 opposed and 0 abstentions, and 1 excused the motion was approved.

**4. Presentation, Discussion, and Appropriate Action Regarding Proposed Legislation for the 2007 Legislative Session Relating to the ASRS.**

**1. Retiree Graded Multiplier**

Prospective increase in retiree benefit for those retiring before effective date of graded multiplier.

Dr. Letson addressed the issue of the graded multiplier. He feels that the Board should do away with it altogether. His input was acknowledged by the Committee.

Mr. Klein presented this proposed legislation to the Committee, and then informed Mr. Gutierrez of speakers wishing to address this topic. Linda Somo, representing the Coalition of ASRS Retirees and the Arizona Education Association, was introduced to the Committee.

Ms. Somo began by commenting on Dr. Letson's opinion regarding the graded multiplier. She feels it is not in the best interest of the ASRS or its members to terminate the graded multiplier altogether. Her purpose today was to encourage the Committee to provide equity to those who retired prior to May 8, 2001 when the graded multiplier went into effect. She feels that retirees who retired on lower salaries with smaller multipliers did not get the benefit, even though they may have worked 20 years prior to retirement. She would like to have the support of ASRS as they present this issue to the legislature again this year.

Mr. Klein then introduced Alan Johnson, representing the ASU Retirees Association. Mr. Johnson was there to let the committee know that the ASU Retirees Association supports the Graded Multiplier Equity Initiative to be proposed in the 2007 legislative session.

General discussion between Mr. Klein, Dr. Meredith, Mr. Zeman, Mr. Johnson regarding Ms. Somo's and Mr. Johnson's comments.

**2. ASU ORP Initiatives**

Additional one-time election to transfer between ASRS and ORP (after initial election and prior to retirement), establish State of Arizona Health Reimbursement Arrangement, health benefit subsidy for ORP members and exempt postdoctoral scholars from both ASRS and ORP

**3. Monthly Pension Payment Summary Elimination**

Remove requirement to send a monthly pension summary with each check

**4. Burke Employer Appropriations**

Appropriation to settle attorney fees

After Mr. Klein presented these initiatives, general discussion and further explanation took place between Mr. Klein, Mr. Zeman, Ms. Sorensen and Mr. Gutierrez.

**5. Presentation, Discussion and Appropriate Action Regarding the System Proposal**

To review the analysis of System Members' feedback forms, discussions and other System members' correspondence.

Mr. Klein explained that he and Susanne Dobel conducted 17 meetings statewide with System members to get their feedback on how they would feel about transferring to the Plan and receiving a guaranteed benefit. The results of those meetings were that there was limited support for the proposal.

Dr. Meredith requested that the Board be apprised of the analysis of the System members' feedback. Mr. Klein agreed, and confirmed that would be done.

**6. Presentation, Discussion and Appropriate Action Regarding Proactive and Participatory Communications with Members**

Mr. Zeman presented to the Committee that he would like to see the ASRS improve communications in the areas of media, legislators, employee groups and sister agencies.

**7. Future EAC Agenda**

- 1.) Legislative issues
- 2.) Formalize the 2007 External Affairs Committee meeting calendar

**8. Call to the Public**

Dr. Bob Letson of UARA asked what the actuarial estimates are for the reduction in contribution rates for each one of these that have been put forward.

Mr. Klein responded by saying that they are in the process of putting that together, but do not have it available at this time. Mr. Klein assured Dr. Letson that it would be sent to him as soon as it was complete.

Ms. Somo was introduced again, and addressed the Committee regarding the impact of Smart Schools employees and retirees who return to work. She requested that perhaps legislation could be introduced that could correct the issue of retiree's returning to work without having to pay into the ASRS.


Mr. Klein responded saying that they have been addressing this issue with Smart Schools. General discussion took place between Mr. Klein and Mr. Gutierrez.

**9. Adjournment of the ASRS External Affairs Committee**

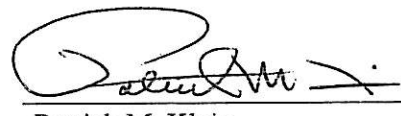
Mr. Gutierrez moved that the External Affairs Committee adjourn.

Mr. Gutierrez, Chairperson of the EAC, adjourned the December 1, 2006 meeting at 11:30 a.m.

Respectfully Submitted by,

  
Melissa Jensen  
Committee Secretary

12/19/06  
Date

  
Patrick M. Klein  
Assistant Director, External Affairs

12-19-06  
Date